



**KANSAS BAR  
ASSOCIATION**

**TO:           The Honorable John Barker**  
                  And Members of the House Judiciary Committee

**FROM:       Robert Alderson, Edwin Hecker, Virginia Harper Ho, Joseph Jarvis, Garrett Roe,**  
                  **William Quick, William Wood, and William Matthews**  
                  On Behalf of the Kansas Bar Association

**RE:           House Bill No. 2713 – Amending the Kansas General Corporation Code and Business**  
                  Entity Standard Treatment Act

**DATE:        March 16, 2016**

Chairman Barker and Members of the House Judiciary Committee:

We appreciate the opportunity to appear today to brief the Committee and answer questions related to HB 2713, a bill requested by the Kansas Bar Association (KBA).

We are members of a special committee created by the KBA's Section on Corporation, Banking & Business Law, composed of Kansas practitioners, academics, and a staff attorney from the Secretary of State's Office. Since October 2014, we have worked to draft amendments to the Kansas General Corporation Code (KGCC) and related business entity statutes, including the Business Entity Standard Treatment (BEST) Act. Our proposed bill seeks to accomplish three general purposes. Principally, we have worked to bring the KGCC, and corresponding applicable provisions of the BEST Act, up to date with appropriate innovations adopted by Delaware since 2000, the last comprehensive update of the KGCC. Second, we have made technical changes to the KGCC to clean up issues following the adoption of the BEST Act. Finally, we have proposed certain changes to the KGCC, the BEST Act, and other business entity laws requested by the Secretary of State's Office and the Bank Commissioner's Office.

Our testimony today has three goals. First, we wish to provide a brief background on the relationship between Kansas's and Delaware's corporation laws and the benefits Kansas has derived from that relationship. Second, we have briefly highlighted those provisions of the proposed bill that we feel are most significant or innovative. Lastly, we note several features of Delaware law that we feel should be considered in separate legislation or are not appropriate for Kansas to adopt, at least at this time.

### **Relationship Between Kansas's and Delaware's Corporation Laws**

Formally as a matter of policy since the adoption of the KGCC in 1972 and informally long before then, Kansas has patterned its corporation laws on the Delaware General Corporation Law (DGCL). The reasons for this policy are numerous. The DGCL is broadly acknowledged as the preeminent body of corporation law in the world, as evidenced by the number and size of corporations formed in Delaware. More than half of all publicly-traded companies in the United States, including 64% of the Fortune 500, are incorporated in Delaware. Delaware has created a specialized court, the Court of Chancery, that only hears corporate and business law cases. Its judges are selected for their knowledge of business law

matters, and through their work they are considered experts in interpreting business law statutes and issues not controlled by statute. The Court of Chancery produces a high volume of excellent quality decisions each year, resulting in a deep and comprehensive body of case law precedent. The Delaware legislature continually evaluates case law, reviews new business developments, monitors changes in federal law (including federal securities and tax laws), and acts on suggestions from the business community. Nearly every session the Delaware legislature modifies the DGCL and its other business entity statutes to keep them on the cutting edge of learning in these areas.

By patterning the KGCC on the DGCL, Kansas and its businesses and legal community have benefited greatly. By following the DGCL, the KGCC keeps pace with the gold standard and latest legal innovations. Kansas courts have recognized Delaware corporate decisions as persuasive and are able to benefit from its vast body of precedent. Kansas businesses and their legal counsel also have access to this case law, which provide a commodity most sought by business—greater legal clarity so they can plan their affairs. In HB 2713, our committee has sought to continue the policy that has been the foundation of Kansas corporate law for more than four decades.

### **Significant Provisions in HB 2713**

*Various Sections Throughout.* We propose removing from the KGCC redundant or conflicting provisions with the BEST Act and updating cross references to applicable provisions of the BEST Act. These changes are considered technical in nature and are not intended to be substantive.

*New Section 1.* This section clarifies that the Kansas district courts have broad jurisdiction to interpret, apply, enforce, or determine the validity of corporate documents, instruments, and certificates, except to the extent that a Kansas statute confers exclusive jurisdiction on a court, agency, or tribunal other than the district court. Further, any civil action to interpret, apply, or enforce any provision of the KGCC may be brought in a Kansas district court. This allows (but does not require) a matter to be brought in a Kansas district court notwithstanding any choice of venue provision to the contrary contained in any corporate documents, instruments, or certificates (*i.e.*, Kansas courts may not be excluded as a proper venue for hearing matters under the KGCC).

*New Section 4 and Various Sections Throughout.* An ongoing issue with the KGCC (and previously with the DGCL) is the inconsistent treatment or non-treatment of non-stock corporations, which include all non-profit and tax-exempt corporations. Following Delaware's lead, our bill fixes this issue by comprehensively addressing the treatment of non-stock corporations—distinguishing which provisions apply and do not apply non-stock corporations, making substantive changes to several provisions to distinguish treatment of non-stock corporations, and establishing a general rule that provisions applicable to general corporations and their stockholders are applicable to non-stock corporations and their members, unless otherwise specified.

*New Section 5.* This section allows, but does not require, the articles of incorporation or bylaws to designate Kansas courts as the exclusive venue to bring internal corporate claims. An “internal corporate claim” means a claim in the right of the corporation to which the KGCC confers jurisdiction upon a district court or that is based upon a violation of a duty by a current or former director, officer, or stockholder.

*New Sections 8 and 9.* These sections adopt a procedure that allows for the ratification of one or more past defective corporate acts because of a lack of necessary authorization or because of a breach of a statutory or other requirement. The procedure creates a new filing, a certificate of validation, for the correction of a prior act involving a corporate filing. The new provision is a safe harbor and does not exclude other methods of validating defective acts. The provision also provides for recourse to the

district courts to hear and review the validity of any corporate act or transaction or any attempted ratification under the new procedures.

*Sections 11-13, 126, 128, and 140-143 (K.S.A. 17-2036, 17-2718, 17-4634, 17-7510, 17-76,139, 56-1a606, 56-1a607, 56a-1201, and 56a-1202).* The Secretary of State’s Office annually rejects a large number of annual report filings for a variety of business entities (in addition to corporations) based on commonly repeated mistakes. Many filers fail to date the annual report, a current statutory requirement. Many annual reports are due at the same time as federal tax filings for the entity. Often the annual report is postmarked on or close to the due date—a practice which is timely for federal tax filings but not currently sanctioned for annual report filings. These mistakes result in many annual reports being rejected and the business entity forfeiting its existence or authority to do business. The fallout of these mistakes is increased expense and hassle by businesses to reinstate their status and many hundreds of hours expended by the Secretary of State’s staff in handling rejections and processing reinstatements. The changes in these sections eliminate the dating requirement and create a limited postmarking exception for the timely filing of annual reports. Our committee deemed these changes relatively immaterial from a substantive legal perspective.

*Section 20 (K.S.A. 17-6009).* This change prohibits attorney fee-shifting clauses in articles of incorporation or bylaws for internal corporate claims, including claims for breach of fiduciary duties. This follows a change adopted by Delaware in 2015 that reverses a Delaware Supreme Court opinion finding such provisions can be valid and enforceable. This provision does not restrict the adoption of fee-shifting provisions in other documents, such as shareholders agreements.

*Section 29 (K.S.A. 17-6305).* This section adopts a new subsection (k), which allows the district courts to determine fee and cost advancement obligations summarily. This addresses a problem often faced by directors, officers, and others indemnified by a corporation of bearing the expense of indemnified claims, sometimes for years, before an adjudication of their advancement rights.

*Sections 31 and 34 (K.S.A. 17-6402 and 17-6407).* These changes allow greater flexibility for the issuance of stock and rights in stock, such as options. As changed, boards of directors no longer must separately determine the acceptability of consideration to be paid for stock, so long as the consideration is in the form of cash, tangible or intangible property, any benefit to the corporation, or any combination of those. Subject to certain conditions, such as the maximum number of shares to be issued, duration of issuance, and minimum amount of consideration to be paid, boards may determine the manner and amount of issuing shares of stock, including by delegation. Finally, boards may determine the price of stock by reference to a formula. In combination, these changes make it easier for boards to use “at-the-market” or other periodic financing techniques.

*Section 51 (K.S.A. 17-6506).* A change to this section resolves a potential “ping pong match” between conflicting bylaw amendments adopted by stockholders and the board of directors, at least with respect to the election of directors. Bylaws adopted by the stockholders specifying the vote required to elect directors may not be amended or repealed by the board of directors.

*Section 58 (K.S.A. 17-6515).* A proposed new subsection (c) provides a direct cause of action by a shareholder or the corporation for the district court to remove a director convicted of a felony or a breach of the duty of loyalty in connection with the director’s duties. Such an action may only be brought after the action determining the conviction or breach.

*Section 61 (K.S.A. 17-6518).* Delaware law has long allowed shareholder approval by written consent of the number of shareholders having the votes that would be required to pass the action at a shareholder meeting. Currently, Kansas requires unanimous shareholder agreement for a written consent. This

change would place Kansas law in conformity with Delaware law and resolve conflicts with other current Kansas provisions (*e.g.*, shareholder appraisal rights) that follow Delaware law and assume the written consent provision also follows Delaware law. These changes also allow for consents to be effective at a future time, including upon the occurrence of a future event, but no later than 60 days.

*Section 78 (K.S.A. 17-6801).* Under current Kansas and Delaware law, the stockholders must consent to the proposed sale of all or substantially all of the assets of a corporation. What has not been clear is what shareholder vote is required by the sale of all of the assets of a wholly owned subsidiary—whether it is the board of directors of the parent (who normally act on behalf of the parent as the shareholder) or the shareholders of the parent? As amended, the distinction between a parent corporation and its wholly owned subsidiary is ignored for this purpose. So, the sale of all or substantially all of the assets by a wholly owned subsidiary entitles the shareholders of the parent to vote, and a sale of all or substantially all of the assets from a parent to a wholly owned subsidiary does not trigger a shareholder vote. It should be noted that this provision does not deal with whether shareholders are entitled to vote on an asset sale transaction of a subsidiary that is not wholly owned.

*Section 86 and New Section 6 (K.S.A. 17-6810).* These sections adopt a procedure that corporations may elect to follow in winding up their affairs, paying claims against the corporation’s assets, and distributing any remaining assets to the stockholders. These sections are designed to provide a safe harbor to absolve directors or other governing persons of a “successor entity” from personal liability for unpaid claims of the corporation, if the procedures described in these sections are followed. The outlined process bears many resemblances to the procedure for claims against a decedent estate, including notice to creditors, determination and prioritization of claims, and orderly payment of claims by defined priority. This process is court-supervised and includes a court determination of the amount and form of security for claims that are contingent, conditional, or unmatured or otherwise have not arisen but are likely to arise.

*Sections 131 and 132 (K.S.A. 17-7918 and 17-7919).* These sections include certain filing-related changes requested by the Secretary of State’s Office and the Banking Commissioner’s Office. The changes relate to the names of corporate entities regulated by the Banking Commissioner, including fixing language in the BEST Act that potentially allowed the Secretary of State’s Office to regulate the names of certain entities that have been exclusively regulated by the Banking Commissioner’s Office.

## **DGCL Provisions Not Included**

We did not propose to adopt provisions in the DGCL applicable to cross-entity mergers (mergers between a corporation and a non-corporation, such as a limited liability company, limited partnership, etc.), including a cross-entity equivalent to a short-form merger. Generally, cross-entity mergers are covered by Kansas’s existing Business Entity Transactions Act, and our committee determined that there currently was little or no need to adopt a short-form cross-entity merger.

In the past several years, Delaware adopted comprehensive reform of the regulation of resident agents (called “registered agents” in Delaware), including special provisions applicable to “commercial registered agents” who serve as registered agent for more than 50 entities. Unlike the volume of entities handled by Delaware, the Secretary of State’s Office determined that the current system is adequate to manage resident agents in Kansas. Section 134 of the bill (K.S.A. 17-7925) proposes certain minor changes to requirements for resident agents, including expanding the types of entities that may serve as resident agents.

Although our committee favors its adoption, HB 2713 does not include provisions applicable to a new corporation type—the public benefit corporation. A variation of the public benefit corporation has been adopted or currently is being considered by more than 35 other states, including Delaware’s adoption in

2013. We believe the adoption of the public benefit corporation expands the choice of business form, facilitates the access to new sources of private financing directed at this corporation type, gives Kansas entrepreneurs the freedom to conduct business without restrictions applicable to nonprofit corporations, and keeps Kansas competitive as a forum for new entity formation. However, we understand that this change could be seen as more significant. We have proposed the adoption of these changes in a separate bill.

## **Conclusions**

We believe that HB 2713 advances Kansas's reputation as being business friendly and at the forefront of innovations in business law. Adopting this legislation continues Kansas's policy of leveraging cutting edge developments and the body of case law advanced by Delaware to the benefit of Kansas and its business community.

We thank you for the opportunity to appear today and your patience. We would be happy to attempt to answer your questions.

Respectfully Submitted,

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